

DOCUMENT OF INTERNATIONAL MONETARY FUND AND FOR OFFICIAL USE ONLY

The contents of this document are preliminary and subject to change.

GRAY/20/2372

CONFIDENTIAL

June 9, 2020

**Statement by Mr. Poso and Mr. Vaikla on 2020 Mid-Year Risk Update
(Preliminary)
Executive Board Meeting
June 11, 2020**

We thank the Office of Risk Management (ORM) for their work and for the comprehensive set of reports. We appreciate the Quarterly Risk Updates, regular engagements with the Board and the program updates on a weekly basis. We also thank the First Deputy Managing Director for his Buff statement.

The Fund has provided effective response to the current unprecedented crisis and deployed its significant financial resources for the benefit of the membership. With the actions taken, the Fund has acted by its mandate and thereby mitigated strategic and reputational risks as well as the risks to its members. Meanwhile, the Fund's overall risk profile has shifted up, which requires close attention. We are especially concerned about the further rise of already high program portfolio risks and increased risks to the Fund's resources, which call for enhancing the monitoring of risks and applying sufficient risk mitigation measures. We share the view that risks related to the Fund's own operations and staff's safety have been managed well so far, while risks to human capital and information security remain elevated.

We support the recent actions taken to improve the Fund's risk management. However, due to the substantial rise in risk levels across the board, we see scope for strengthening it further. The changing nature of the Fund's lending portfolio and the surge in the Fund's use of resources call for strengthening ex ante risk assessment, monitoring the interconnectedness of risks, scenario analysis of resource needs, and ensuring that effective risk mitigation measures are being put in place. We also call for further incorporation of ex ante enterprise risk assessment in major policy proposals.

Given that the Board's risk tolerance has increased, we support reviewing institutional risk acceptance levels in November. The risk tolerance levels should be based on measurable quantitative levels, to the extent possible. We would like to offer the following comments on specific risk areas for emphasis.

The risk of **adequacy of the Fund's resources** and thus the Fund's ability to fulfil its mandate is the primary risk going forward. We agree that overall, the GRA resources appear to be adequate in the near term, while substantial uncertainty regarding demand for the Fund's resources poses a clear risk over the longer horizons. The NAB and the BBAs are available tools to control the resource adequacy risk, but only on the GRA side. We emphasize that the Fund needs to have a quantitative assessment of financial risks by analyzing a potential need for Fund resources under different scenarios, including simultaneous use of our credit lines.

We are particularly concerned of the unprecedented increase in the use of PRGT resources, which are not sufficient to secure longer-term sustainability of the Fund's concessional financing. Our resources will never be enough to meet all concessional financing needs, and therefore, the risk of not serving the membership evenhandedly should also be mitigated. The Fund's catalytic role and access policy are key tools to control this evenhandedness risk.

We share ORM's assessment that **program risks** are extremely high and take note that risks have increased to "high" in all four subcategories. While the Fund should have a higher risk profile in current circumstances, implementation of proper risk mitigation measures has never been as important as now. Ensuring efficient and effective use of Fund resources is of utmost importance in the midst of a global crisis of unprecedented scale. On that regard, we emphasize that safeguard measures need to be applied consistently and in a unified manner across the membership, tailored to country-specific circumstances when necessary, to ensure the transparent and effective use of Fund resources. Safeguard measures are important also to mitigate risks resulting from program errors due to time pressures and misuse of public funds. We fully agree with the ORM, that any decisions on "additionality" in the context of access limits could have implications for risks to the revolving nature of lending resources. Furthermore, increasing cumulative access limits would fundamentally change the Fund's risk tolerance, compromise the borrower country's path to sustainable debt levels, as well as its ability to repay to the Fund.

On **capacity development**, we welcome that the Fund has adapted quickly to the new environment and that over 90 percent of members who have requested emergency financing have also benefitted from CD activities. However, we note that rigidities in the CD financing architecture risks the Fund's ability to deliver CD in some urgent areas, which requires introducing additional flexibility in providing CD. As a risk mitigation effort, we emphasize that CD activities should be demand-driven and prepared in close cooperation with country teams who have the best knowledge and oversight of members' needs and absorptive capacity. As the CD demand is likely to increase after the crisis, the IMF CD crisis response and changes in delivery also need to be discussed with the donors to ensure that funding continues.

On **surveillance risks**, we note that the unprecedented nature of the crisis and highly uncertain trajectory of the virus has significantly raised risks to forecasting accuracy and challenged monitoring of spillovers. Mitigation of surveillance risks is especially relevant when conditionality is absent in the emergency financing cases and greater emphasis is put on ex ante surveillance and forecasts. We therefore encourage greater use of scenarios in

macroeconomic analysis and continued close cooperation with health experts. Given rising risks to financial stability, we call for deepening the integration of macro-financial surveillance and debt sustainability issues.

On **medium-term budget**, we acknowledge that responding to the membership's significant needs in ongoing crisis may exhaust budget buffers, while budgetary implications going forward are very uncertain. However, we do not fully share concerns about budget risks as crises always require a reprioritization of tasks and in this case provide also cost savings in the form of suspended travel. Thus, we continue to support the flat real growth budget in the medium-term and continued budget discipline. We encourage the Fund to implement risk-based resource allocation and productivity-enhancing measures to mitigate budget risks. We would not want to pre-judge the outcome of the Board discussion later this year on a possible supplementary budget. Such a request would need to include a thorough assessment of resource reallocations already made within the existing budget envelope, an analysis of the allocation of the additional carryforward approved with the budget proposal, and clear justification for any additional resource requests, grounded in the Board's crisis work program.

On risks to **human capital**, we share the assessment that the COVID-19 crisis has put significant pressures on Fund staff, particularly due to increased workload, in combination with challenges associated with work-from-home (WFH) arrangements. We welcome the initiatives taken by HRD to swiftly address the immediate work pressures, including the Resource-Sharing Exchange website, the rehiring of recent Fund retirees, and the extension of contractual employees. These measures are appropriate also in light of the additional complexities to recruitment and onboarding due to travel restrictions and continued WFH arrangements.

On **information security**, we note with concern the worsened cyber threat landscape reflected in the substantial surge in malicious threats, which underlines the importance of strengthening the Fund's information security. While we acknowledge the staffing shortages and the shift of priorities due to the COVID-19 related disruptions, we urge to continue with the Crown Jewels project once the situation normalizes to implement an already delayed security risk mitigation roadmap. Given the heightened risks to the Fund's information security and that the Information Security Road Map is expected to be completed only in FY2024, we urge ITD and Management to find ways to accelerate its implementation.